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Management from the NOVA – School of Business and Economics

“HOW TO ACHIEVE A PROFITABLE BRAND EXPANSION OF 24 KITCHEN IN
PORTUGAL”

Pricing Strategy

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1. Pricing

“If effective product development, promotion, and distribution sow the seeds of business success, effective price is the harvest” (Armstrong et al., 2009). “More broadly, price is the sum of all the values that customers give up in order to gain the benefits of having or using a product or service” (Nagle & Smith, 1994), and so the price’s job is to “(...) specify how the value that has been created can be divided appropriately between the customer (providing an incentive to buy the product) and the organization (covering the costs associated with the value-creation effort and providing funds for profit and reinvestment in the organization)” (J.Dolan & Gourville, 2015). To better understand the strategies to be applied in the case of 24 World, some concepts shall firstly be clarified:

1.1 Pricing Approaches

Although several strategies can be applied for setting the price, two pricing approaches remain the most popular ones: cost-based and value-based/ customer-driven. On the first, “the company designs what it considers to be a good product, adds up the cost of making the product, and sets a price that covers cost plus a target profit.” (Kotler et al. ,2008). However, as costs vary throughout the business and its circumstances, it is not only difficult to estimate the exact costs to be covered but, in case costs increase, a consequent increase in price can lead to a decrease in sales and profits. Moreover, as costs usually depend on volume bought to manufacturer, and the sales volume purchased by consumers depends on the price, this circularity reveals flawed (Nagle & Hogan, 2011). On the other hand, value-based pricing means basing the price on the value it represents for consumers (J.Dolan & Gourville, 2015) and “involves understanding how much value consumers place on the benefits they receive from the product and setting a price that captures this value” (Kotler et al. ,2008). Upon covering costs, inputs such as prices of competition, price sensitivity and indicated willingness to pay (unveiled through market research) are the key inputs for settling the price (Nagle & Smith, 1994). Therefore, “customer

perceptions of the product's value set the ceiling for prices. If customers perceive that the price is greater than the product's value, they will not buy the product" (Kotler et al. ,2008). However, consumers can easily manipulate sellers to push the prices down to a point that does not reflect its value (Nagle & Smith, 1994), and so sales and marketing departments ought to work not to follow consumers' willingness to pay but to raise such (Nagle & Hogan, 2011). Other approaches on pricing can be driven by competition or profit, for instance.

1.1.2 Value-Based Pricing: True Economic Value, Perceived Value & COGS

Following a value-based strategy means, firstly, to assess the true economic value for the consumer, meaning that, having several options to choose from, an informed buyer will make his decision relative to the next-best alternative, considering performance factors that are important to him in a way that justifies the price differential. It can be computed as: **cost of the next-best alternative + value of the performance differential**. (J.Dolan & Gourville, 2015). It assumes that the consumer is smart and fully informed on the market, its conditions and his own valued characteristics, and so he will pay to get the best value (Nagle & Hogan, 2011). However, not every shopper is a smart and fully informed one in a way that makes him able to assess the precise economic value of an offering, attributing only a perceived value (PV) to such. Thus, the PV corresponds to "the perceived value of the product in the mind of the consumer" (J.Dolan & Gourville, 2015), and so it requires market research. Although being computed as well by: **cost of the next-best alternative + value of the performance differential**, the PV usually falls short on True Economic Value, as the buyer might not be aware of the relative benefits of the product or might be skeptical about such claims and their relevance (J.Dolan & Gourville, 2015). For this reason, sales and marketing communications efforts are responsible for increasing this perception by offering features that the consumer shall perceive as relevant and valuable enough to justify the price (Nagle & Hogan, 2011). If effective, such efforts should "transform an uninformed, skeptical customer (with a resulting low PV)

into a fully informed, rational buyer (whose PV approaches TEV)” (J.Dolan & Gourville, 2015). However, despite the value focus, costs of producing the product sold need to be as well taken into consideration. “Whereas customer-value perceptions set the price ceiling, costs set the floor for the price that the company can charge” (Kotler et al., 2008), and so the company should never sell below it as it represents the lowest price that can be established for the business to be sustainable and not encounter money loss. If it does so, the company will have little or no chance of ever becoming profitable, while being able to sell highly above such costs could translate into a thriving business (J.Dolan & Gourville, 2015).

Companies should, then, establish the prices between the ceiling price set by customer’s perception and floor price set by product costs, but considering “(...)a number of other internal and external factors, including its overall marketing strategy and mix, the nature of the market and demand, and competitors’ strategies and prices” (Kotler et al., 2010).

1.1.3 Pricing Strategies

Upon settling for a value-based approach, focusing on the consumer, pricing strategies can be allocated into one of the following categories:

Skim pricing: prices are set highly above what consumers would be convinced to pay, capturing high margins at the expense of large sales volume. Thus, such strategy will convey profitability whenever “the profit from selling to relatively price-insensitive customers exceeds that from selling to a larger market at lower price” (Nagle & Hogan, 2011) which can be achieved if the product shows differentiating attributes that are highly valuable to a segment in the market (Nagle & Hogan, 2011) and so the marketing efforts should be heavy enough to justify such price.

Penetration pricing: using such strategy means setting the price below the value perceived by the targeted segment. The main goal is to attract a great amount of customers and, preferably, keep them. “Penetration pricing will work only if a large share of the market is willing to change brands or suppliers in response to lower prices” (Nagle & Hogan, 2011), however, not every consumer will respond positively to this strategy as it might lower the appeal of the brand. It can be proven successful “without a high contribution margin if the strategy creates sufficient variable cost economies, enabling the seller to offer penetration prices without suffering lower margins” (Nagle & Hogan, 2011).

Neutral pricing: “neutral pricing involves a strategic decision not to use the price to gain market share, while not allowing price alone to restrict it” (Nagle & Hogan, 2011), meaning that the price shall encounter a lower weight than other marketing tools and tactics. However, it needs to be high enough to convey value and make consumers be willing to pay while low enough to reach a great market, and such balance is not always easy to achieve. Moreover, “neutral prices are not necessarily equal to those of competitors or near the middle of the range. A neutral price can, in principle, be the highest or lowest price in the market and still be neutral” (Nagle & Hogan, 2011). In fact, some products “(...) are consistently priced above competitors, yet they capture large market shares because of the high perceived value associated(...). Like a skim or penetration price, a neutral price is defined relative to the perceived economic value of the product” (Nagle & Hogan, 2011).

1.2. 24 World approach

For 2 T4sty! and 24K Live a value-based and neutral pricing would be followed, as further explained. For 24K Product Line, as 24 Kitchen would not own the products nor have influence on the prices as they are established by the manufacturer, a pricing strategy could not be defined by the brand and so the ties with the retailer and earnings for involved parties shall be explained.

2 T4sty! and 24K Live should follow a value-based strategy as “pricing decisions, like other marketing mix decisions, must start with customer value. When customers buy a product, they exchange something of value (the price) in order to get something of value (the benefits of having or using the product)” (Kotler et al., 2008) as well as a neutral policy once prices should be reachable enough to capture consumers while at same time transmit the value offered by each concept. Thus, skim or penetration pricing would not be justifiable.

1.2.1 2 T4sty!

2T4STY! aims to offer an experience that goes beyond its functional value but that not only provides less effort and more convenience but that mainly frees individuals to focus on sharing moments around something as unifying as good food, which justifies a value based and neutral approach.

True Economic Value

To assess the TEV, taking the time to choose a special recipe plus going into the supermarket to find the necessary ingredients to take home was the considered next-best alternative. Simulating 3 recipes of 24kitchen [exhibit 1], the average price for such option is of 14€ (2 people) and 16€ (4 people). For a box of 2, a performance differential of 5,90€ was applied, meaning a final price of 19,90€, while for a 4 people box the differential set was of 13,90€. These premium values estimated to add to the next-best alternative price are not objective but based on the value attributed to: convenience of saving the time and effort of going into the supermarket, getting out of the routine of thinking on what to cook and always cooking the same, sharing experiences in the kitchen with loved ones; as well as to the considered competitive advantages of being a service from 24 Kitchen brand, which attributes the value of talent and expertise in the culinary market, paired with a trustful retailer that assures quality. Furthermore, the divergence in performance differentials is attributed to the reason if consumers

were to go and buy ingredients for 4 people, the difference in terms of ingredients bought would be somewhat small from buying for 2 people, while, at the same time, a box for 4 people becomes easier for the retailer to assemble as little or no adjustments are required to the original products to deliver the adequate and necessary portions. Moreover, by selling at 29,90€, consumers get a purchase incentive as they are expected to perceive it as having one meal for free while, at the same time, the company gets to collect a higher premium.

Perceived Value

Assessing customer's PV requires looking into the major finding of market research. After performing a quantitative questionnaire, potential consumers stated they would be willing to pay between 15€ to 20€ for a box for 2 people [exhibit 2], providing an average of 17,50€ and so the established price was as well establish considering a proximity to consumer's expectations.

Cost of Goods Sold

Sourcing costs for the retailer were determined as follows: after defining the selling price, the same without VAT was computed. To calculate such value, the VAT considered was the one applied over supermarket products instead of the one from the take away market as it was considered a closer estimation once the products will arrive to consumer's house coming from the retailer stores. After going into the supermarket to assess some products, as some SKUs register a VAT of 6% and others of 23%, the intermediary VAT (13%) was assumed for better weighted calculations. The price without VAT was then split providing a 55% margin for the retailer, meaning 45% of COGS. The respective value division can be seen below:

Table 1: Price composition

2 people box - 19,90€	
PVP	19,90
Price w/o VAT	17,61
COGS (45%)	7,92
Retailer (55%)	9,69

4 people box - 29,90€	
PVP	29,90
Price w/o VAT	26,46
COGS (45%)	11,91
Retailer (55%)	14,55

When deciding 24 Kitchen's revenue strategy, at first it was considered to split the retailer margin between the retailer and the brand. However, upon talking to some finance and accounting professionals, such strategy revealed to be misleading as there could be a high chance that margins would be easily manipulated by the retailer, claiming higher COGS to deceive 24 Kitchen, lowering its revenues and making them inconstant. Therefore, a royal system was set out to be the best way to gain from such service. 24 Kitchen will partner with the retailer by providing recipes, an explanatory video using its very own talents and by providing communication and media exposure. Bearing this factors in mind, a royalty of 10% over the selling price of each box sold was established, providing the brand with the resting guarantee of always earning a fair revenue over sales.

1.2.2 24Live

True Economic Value

As mentioned, the price for the gastronomic fair was settled following a value based pricing strategy. However, looking to the next best alternative was not considered as applicable. It could be eating at home or out, or attending another similar event. However, eating out or at home does not offer several other components present at the fair such as live show-cookings or meeting the stars of the shows and trying their exclusive dishes, for example. Moreover, the price of eating at the restaurant of one of the present chefs cannot be compared to the smaller

versions of such dishes at the fair, and so that could not be a starting point for the price. What is more, 24Live will not occur at the same time as another big fair, so the consumer would not have to choose between two very similar options.

Perceived Value

To assess the value this fair would have for consumers, the quantitative questionnaire was taken into consideration. As seen on exhibit 3, when asked about payment condition preferences, consumers were divided, with 49% saying they would prefer to pay a higher price at entry that would be consumable and 45% preferring to pay a lower entry price, spending the money according to their tastes and needs inside the fair. However, once opinions were fairly divided between the two options, it leaves a margin for choosing the best option according to managerial sensibility as “managerial judgment has some validity when it comes to price sensitivity, especially when one has knowledge or experience in the product category” (J.Dolan & Gourville, 2015). For gaining such sensibility, the group went to two different fairs. In Peixe em Lisboa, the attendees would pay 15€ at entrance, being able to consume 12€ inside, while in Sangue n’a Guelra participants would pay a 4€ entry ticket and would buy the dishes inside. In Peixe em Lisboa consumers would vary their spending, with some being more cautious and spending merely the consumables includes and others spending more, but in Sangue n’a Guelra some consumers stated they would not attend Peixe em Lisboa for perceiving it as expensive. However, looking at their purchases, they found out they had already spent more money than they would by entering Peixe em Lisboa. As the main goal of such fair is to bring awareness to the brand and make it a reference in the culinary market, consumers should have a price incentive to attend it, especially when considering the Portuguese market that, despite the increase in levels of confidence, can still be described as price sensitive. Therefore, to motivate attendance, the entry price established was of 5€, without consumables, providing the consumer with the freedom to spend their money the way they prefer. The highest percentage of inquired

consumers stated that the preferred price range for entry would be 2€ to 3€ (44%), followed by the price range of 4€-5€ (26%), reflecting the price sensitivity. However, “value-seeking customers have put increased pricing pressure on many companies (...) Yet, cutting prices is often not the best answer (...). Reducing prices unnecessarily can (...) signal to consumers that the price is more important than the customer value a brand delivers. Instead, companies should sell value, not price” (Armstrong et al., 2008). Therefore, providing a price lower than 5€ would not be sustainable for the organizing parties as such event incurs several expenses neither would reflect the value of such event and so the established price for lunch was of 6€ as this is usually a time for lower occupation and 8€ for dinner, as demand is expected to be higher. Moreover, as this is, in its core, a gastronomic fair, it is expected that at least most of the consumers spend money inside the fair to eat. Based on comparables, the established price range for starters and desserts would be of 4,5€, while dishes should range between 7€ and 12€, considering that the served portions are of high quality but smaller than the ones of a normal restaurant. Drinks coming from sponsored stands would be expected to cost, on average, 3€. At the end, if visitors consumed either two dishes (average of 10€ spend) or one dish and one dessert/starter (average of 14,5€), they would have spent a price close to the one of entry (with consumables) at Peixe em Lisboa (15€ with consumables of 6€ or 12€ depending on attendance day). Therefore, it is trusted that, through this mechanism, the fair would be able to capture more visitors due to its low entry price, since consumers are expected to feel that they pay an acceptable price to access the experience and have the freedom to choose how they want to spend their money, being more open to attend.

Finally, once 24 Kitchen would simply provide its talents and their recipes as well as communication and media exposure to the event, leaving the partner with all the handling of the organization, a 10% royalty over the entry ticket sales, food stands sales from invited restaurants and fees from gourmet market and drinks sponsors was established. As the stands

for the three 24 Kitchen chefs would have to be dealt with by the partner, in charge of having a cooking team and handling all ingredients and other necessities, 24 Kitchen would fairly receive a lower royalty of 5%.

1.2.3 24Kitchen Product Line

Concerning the product line, 24Kitchen uses a great variety of utensils and objects that are provided from different brands such as Le Creuset or Tescoma. As 24Kitchen would work mainly as a facilitator for consumers who wish to buy what they see on the TV shows, receiving a royalty over the sales that are made through that process, the established price for each product is settled by the brand that provides such items.

To have a sense of what 24Kitchen would gain from such partnership, some items of two partner brands were listed [see exhibit 5 for considered utensils], ranging from simpler and cheaper products to more complex and expensive ones. The chosen brands were Le Creuset, with an average price of 90,5€ for the assessed items and Tescoma, with an average price of 28,6€. One by one, the applied procedure was the following: retrieving the product price without VAT(23%), considering 40% as COGS, leaving a margin of 60% for the manufacturer. Based on the previous experience from 24 Kitchen's brand manager in a similar business, over the selling price a royalty of 4% would go for 24Kitchen. Some examples of revenues gained can be seen below:

Le Creuset							
	Cocotte	Trey Set	Pie tray	Whisk	Tea Pot	Cruet	Wood Cade knives
PVP	249,00 €	70,00 €	15,00 €	18,00 €	95,00 €	49,00 €	137,80 €
Price w/o VAT	202,44 €	53,90 €	11,55 €	13,86 €	73,15 €	37,73 €	106,11 €
COGS (40%)	80,98 €	21,56 €	4,62 €	5,54 €	29,26 €	15,09 €	42,44 €
Manufacturer (60%)	121,46 €	32,34 €	6,93 €	8,32 €	43,89 €	22,64 €	63,66 €
24 kitchen (4%)	8,10 €	2,16 €	0,46 €	0,55 €	2,93 €	1,51 €	4,24 €

Tescoma							
	Frying Pan with 4 holes	Frying Pan	Conservation kit with thermometer	Amber frying pan	Apple peeler	Double face frying pan	VITAPAN frying pan
PVP	19,90 €	9,90 €	35,90 €	34,90 €	19,90 €	39,90 €	39,90 €
Price w/o VAT	16,18 €	8,05 €	29,19 €	28,37 €	16,18 €	32,44 €	32,44 €
COGS (40%)	6,47 €	3,22 €	11,67 €	11,35 €	6,47 €	12,98 €	12,98 €
Manufacturer (60%)	9,71 €	4,83 €	17,51 €	17,02 €	9,71 €	19,46 €	19,46 €
24 kitchen (4%)	0,65 €	0,32 €	1,17 €	1,13 €	0,65 €	1,30 €	1,30 €

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APPENDIX

Exhibit 1: Next best alternative – simulation of 3 24 Kitchen recipes

Next best alternative : buying the ingredients at store

Mexican Recipe - Pepper filled with chilli (2people)			
Needed dose	Ingredients	Cost	Unity
250g	Minced Meat	2,89	700g
250g	Red Beans	0,55	360g
0,5 each + 2 yellow	Red, Green, yellow pepper	3,49	425g
0,5	Onion	0,13	1
1	Garlic	0,5	1
1 leaf	Blond	1,05	10g
100ml	Tomato Sauce	0,84	500g can
	Pepper	1,49	45g
150g	Vaporized rice	0,89	1kg
	Piri Piri	0,97	210g
	Total	12,8	

Mexican Recipe - Pepper filled with chilli (4 people)			
Needed dose	Ingredients	Cost	Unity
500g	Minced Meat	2,89	700g
500g	Red Beans	1,1	850
1,1,4 yellow	Red, Green, yellow pepper	3,49	350g
1	Onion	0,13	1
2	Garlic	1	2
2 leaves	Blond	1,05	10g
200ml	Tomato Sauce	0,84	500g can
	Pepper	1,49	45g
300g	Vaporized rice	0,89	1kg
	Piri Piri	0,97	210g
	total	13,85	

Italian Recipe - Penne all'arrabiata			
	Ingredients	Cost	Unity
1	Pepper	2,95	200g
1,5	Garlic	1	2
0,5	Tomato	0,96	1 can
0,5 tea spoons	Thyme	1,4	15g
0,5 tea spoons	Oregano	0,89	8g
1 tea spoon	Basil	0,99	20g
1 soup spoon	Balsamic vinegar	1,99	250ml
1 tea spoon	Sugar	0,99	1kg
	Fresh basil	1,25	20g
	Parmesan cheese	0,89	40g
150g	Penne pasta	0,9	500g
	Total	14,21	

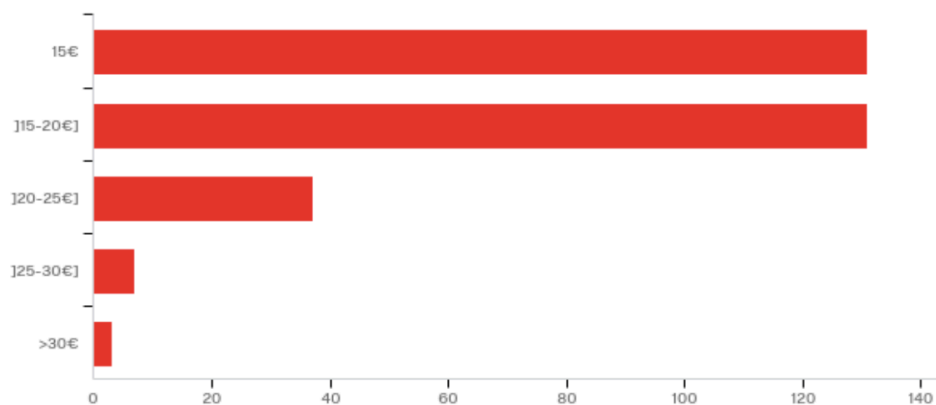
Italian Recipe - Penne all'arrabiata			
	Ingredients	Cost	Unity
1	Pepper	2,95	200g
3	Garlic	1,5	3
1 can	Tomato	0,96	1 can
1 tea spoon	Thyme	1,4	15g
1 tea spoon	Oregano	0,89	8g
2 tea spoons	Basil	0,99	20g
2 soup spoons	Balsamic vinegar	1,99	250ml
2 tea spoons	Sugar	0,99	1kg
	Fresh basil	1,25	20g
	Parmesan cheese	0,89	40g
300g	Penne pasta	0,9	500g
	Total	14,71	

Asian Recipe - Eggplant Daal and Home Made Chapattis			
	Ingredients	Cost	Unity
1	Eggplant	0,97	1
0,5	Red Onion	1,35	500g
1	Garlic	0,5	1
0,5	Ginger	0,6	1
	Peanut Oil	3,25	1lt
166g	Peas	0,45	300g
1	Vegetable stock	1,49	80g*8
83g	Wholemeal flour	0,79	500g
320g	Basmati rice	1,89	1kg
1 hand	Curry	1,19	45g
1 tea spoon	Mustard seeds	1,99	50g
1 tea spoon	Curry paste	0,9	50g
	total	15,37	

Asian Recipe - Eggplant Daal and Home Made Chapattis			
	Ingredients	Cost	Unity
2	Eggplant	1,94	2
1	Red Onion	1,35	500g
2,5	Garlic	1,5	3
1	Ginger	0,6	1
	Peanut Oil	3,25	1lt
333g	Peas	1,35	2*300g
2	Vegetable stock	1,49	80g*8
166g	Wholemeal flour	0,79	500g
320g	Basmati rice	1,89	1kg
	Curry	1,19	45g
0,5 tea spoon	Mustard seeds	1,99	50g
	Curry paste	0,9	50g
	TOTAL	18,24	

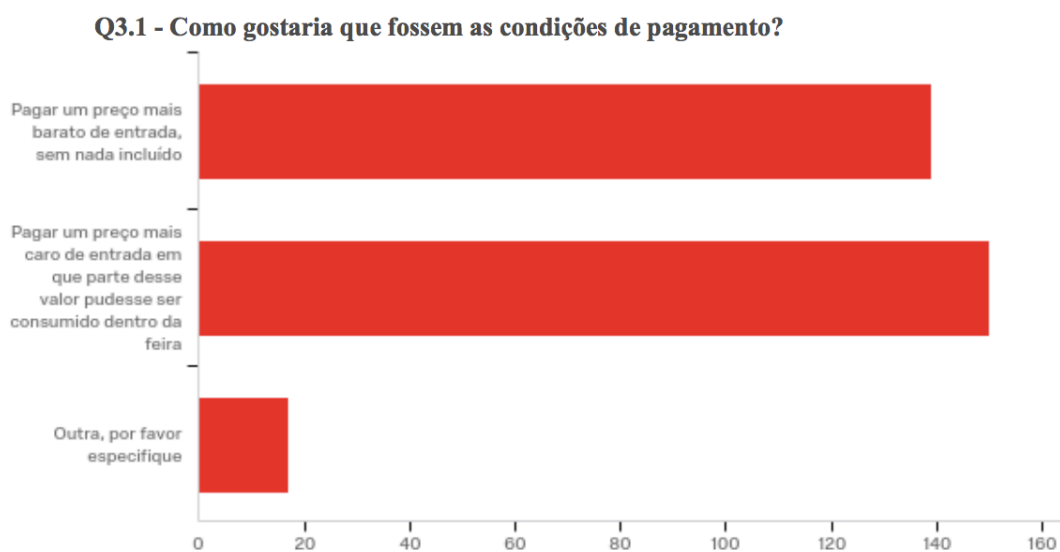
Exhibit 2: Potential consumers' expressed willingness to pay

Q2.2 - Quanto estaria disposto a pagar por uma caixa de ingredientes com receita para 2 pessoas?



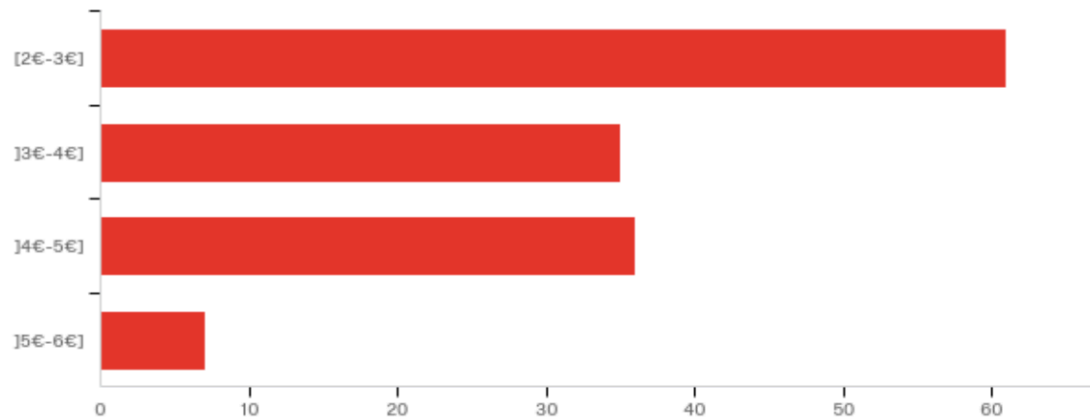
Answer	%	Count
15€	42.39%	131
]15-20€]	42.39%	131
]20-25€]	11.97%	37
]25-30€]	2.27%	7
>30€	0.97%	3
Total	100%	309

Exhibit 3- Potential attendee's expressed preferred fair conditions



Answer	%	Count
Pagar um preço mais barato de entrada, sem nada incluído	45.42%	139
Pagar um preço mais caro de entrada em que parte desse valor pudesse ser consumido dentro da feira	49.02%	150
Outra, por favor especifique	5.56%	17
Total	100%	306

Exhibit 4- Potential attendee's expressed willingness to pay

Q3.2 - Quanto estaria disposto(a) a pagar para entrar?


Answer	%	Count
[2€-3€]	43.88%	61
[3€-4€]	25.18%	35
[4€-5€]	25.90%	36
[5€-6€]	5.04%	7
Total	100%	139

Exhibit 5- 24K Line example assortment